

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 02-0354
Gross Income & Sales/Use Tax
For the Years 1991-2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales and Use Tax- Calculation

Authority: IC 6-2.5-2-2.

The taxpayer protests the method of calculating the tax due for 1991.

II. Tax Administration- Fraud Penalty

Authority: IC 6-8.1-10-4, IC 6-2.5-2-1 (b), 45 IAC 15-5-7 (3).

The taxpayer protests the imposition of the fraud penalty.

STATEMENT OF FACTS

The taxpayer owns and operates an automotive repair shop. The taxpayer is not incorporated and reports the business income on his individual income tax return. The taxpayer bills his customers separately for the service and parts, collecting sales tax from customers on the parts. The taxpayer paid sales tax when he purchased the parts. The taxpayer never registered with the state to collect sales tax or remitted the collected sales tax to the state. In an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," gave the taxpayer credit for sales taxes incorrectly paid when the taxpayer purchased the parts for resale to his customers. The audit also assessed sales tax on the parts the taxpayer sold to customers and use tax on tangible personal property used by the taxpayer. After the audit, the department assessed additional tax, interest and the fraud penalty. The taxpayer protested the calculation of the tax due for 1991 and the assessment of the fraud penalty.

I. Sales and Use Tax- Calculation

DISCUSSION

Due to a fire, the taxpayer only had sales tax records for the years 1999 and 2000. The taxpayer and department agreed to use the 1999 and 2000 records to develop percentages to be applied in determining the sales tax due for 1991-1998. To determine taxable sales and purchases, these percentages were applied to the gross sales and cost of purchases taken off past tax returns. At

the time of the audit, the taxpayer was able to provide copies of all tax returns other than 1991. The department used an average of sales and part purchases for the previous years to arrive at the taxable sales and purchases for 1991. After the audit, the taxpayer obtained a copy of the 1991 tax return from the IRS. The taxpayer presented the actual return at the hearing and requested that the tax due be recalculated based upon the actual figures on the tax return rather than the estimate used in the audit.

Pursuant to IC 6-2.5-2-2, the sales tax “is measured by the gross retail income received by a retail merchant in a retail unitary transaction.” The taxpayer’s production of the previously missing 1991 income tax return provides the means to compute the actual amount of the gross retail income subject to the income tax that was received by the taxpayer in 1991. It is preferable to determine the tax due from the actual 1991 income figures rather than from an estimate of taxpayer’s 1991 income..

FINDING

The taxpayer’s protest is sustained and the 1991 sales tax due will be recalculated based upon the 1991 tax return.

II. Tax Administration- Fraud Penalty

DISCUSSION

The taxpayer protests the imposition of the one hundred per cent (100%) fraud penalty.

The fraud penalty is imposed pursuant to IC 6-8.1-10-4 as follows:

If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, the person is subject to a penalty.

The Regulations set out five required elements for establishing fraud. These five elements are found at 45 IAC 15-5-7 (3) as follows:

(A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department’s regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.

(B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person’s duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purposes of proving fraud.

(C) Deception: Deception operates on the mind of the victim of the fraud. If a person’s actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.

(D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

(E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

The department and the taxpayer agree that the elements of misrepresentation of a material fact, deception, reliance, and injury are met in the taxpayer's situation. The issue to be determined is whether or not the taxpayer exhibited the element of scienter in his actions.

The taxpayer argues that he did not have the requisite scienter or guilty knowledge necessary for two reasons. First he thought that he didn't need to remit the collected taxes because he paid taxes when he purchased parts. Secondly, the taxpayer argues that the preparer of his income tax returns had a duty to inform the taxpayer of his obligation to remit the sales taxes that the taxpayer collected from consumers.

Scienter can be imputed to the taxpayer through his actions. It is common knowledge that taxes are monies used to fund government and must therefore be remitted to the government. The taxpayer clearly knew of sales taxes. He paid taxes when he purchased tangible personal property. His computer programs automatically billed sales tax. He collected and retained sales tax exemption certificates. The taxpayer knew to remit his income taxes to the state. He also knew to do planning so he would not have to remit withholding taxes to the state. The taxpayer's explanation that he didn't know he was obligated to remit collected sales taxes to the state defies credulity. Nor does the taxpayer offer any explanation for his collection and retention of the sales taxes.

Further, the taxpayer took his income tax information to a tax preparer that advertises a specialty in the preparation of income taxes for preparation of his income tax returns. A tax preparer that specializes in income taxes and is hired to prepare income taxes has no duty to inform taxpayers of obligations to pay other taxes. The department has offices throughout the state, a web site, and publications to instruct merchants how to collect and remit sales tax.

Pursuant to IC 6-2.5-2-1 (b), merchants collect the sales tax as an agent for the state. At no time did the taxpayer own or have any personal right to the collected sales taxes. The taxpayer's actions indicate that he knew taxes were to be remitted to the state. The taxpayer's self enrichment through the retention of collected sales taxes constitutes fraud.

FINDING

The taxpayer's protest is denied.